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The City Clearing House: Payment, Returns, and Reimbursement

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This is the fourth of a series of articles about the city clearing house. The first article contains a description of the clearing operation which takes place at the clearing house. There the checks and other items are exchanged by the member banks, after which the representative of each bank brings to his bank the items drawn upon it. At the drawee bank the items are examined to determine whether they will be honored or dishonored. Among other things, the bank examines the drawer's signature for possible forgery, and the state of the drawer's account for the possibility of insufficient funds. It also looks to see whether payment has been stopped on the particular check.

It is obvious that provision must be made for the return of items which the drawee bank wishes to dishonor, and the various clearing house regulations cover the subject of returns and reimbursement in detail. The time for returning items is generally specified in the clearing house regulations.

It has been argued that banks have no right to return items once they have been exchanged at the clearing house. The argument is based upon the theory that the exchanges at the clearing house constitute final payment of the item. The fallacy of the argument becomes apparent.

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5. The comparatively recent statutes on deferred posting and delayed returns will be referred to later. Before their adoption, the deadline for returning dishonored items was generally a specified hour in the afternoon of the day when the items were received.
upon consideration of the fact that no opportunity is afforded at the clearing house for the examination of the items exchanged. They remain in their envelopes or packages and, unopened, are brought to the drawee bank by its messenger, where, for the first time, the individual items are checked and the state of the drawer's account investigated. To hold that the debits and credits at the clearing house constitute final, irrevocable payment, precluding the return of so-called "not good" items, would result in gross injustice and would evidence a complete failure to comprehend the purposes and methods of the clearing routine. Fortunately, the courts take no such absurd position; instead, they hold, with practical unanimity, that the debits and credits at the clearing house are merely provisional and do not constitute payment.

A glance at some typical factual situations raising the issue will lead to a clearer understanding of its significance. The most obvious case arises from the refusal of the bank which presented the item to take it back and reimburse the drawee. This results in a suit by the drawee against the presenting bank for the amount of the check. Since, by hypothesis, the drawee tendered the item within the time designated by the clearing house rule, the presenting bank will lose.6

More interesting is an action by the presenting bank against the payee-indorser, brought upon the theory that the check has been dishonored, as a consequence of which the indorser must pay it. Here, the presenting bank has refunded the amount of the check to the drawee, and seeks reimbursement from the indorser. The latter contends that since the clearing house transaction constituted payment, he has been discharged.7 In conformity with the rule stated above, the courts hold the indorser liable.8

Another interesting factual situation involved a suit by the administratrix of a deceased depositor in the drawee bank for the amount alleged to be on deposit. The drawee claimed to have paid out the deposit before the depositor's death. The evidence disclosed that the checks in question went through the clearing house, were dishonored by the drawee, and were returned to the presenting bank, which refunded the amount to the drawee. The court very properly held that the clearing house

6. National Exchange Bank v. National Bank of North America, 132 Mass. 147 (1882), is in point, although it contains some rather unfortunate language about the effect of the clearing transaction. As might be expected, the factual situation under consideration has not given rise to much litigation.

7. This would follow from § 120 of the Negotiable Instruments Law provided the check had been paid.

transaction was not payment, although the amount of the checks was credited there to the presenting bank. 9

Several of the cases involved suits by the payee or other owner of the item against the drawee, brought upon the theory that since the events at the clearing house constitute payment, the owner's right to the sum represented by the check has become fixed. In view of the rule that no payment has occurred, the owner will not recover. 10

From the situations presented, it is seen that the courts consistently follow the rule that no payment results from the exchanges at the clearing house. And the mere fact that the drawee has paid its clearing house balance prior to the "return" time, in accordance with the association's rules, does not change the result. 11 This is inevitable, for the clearing house balances are arrived at on the basis of the items exchanged, without regard to their subsequent honor or dishonor by the drawee bank. 12

More difficult is the problem of discovering what constitutes payment after the clearing house checks have reached the drawee bank. The clearing house situation is more readily understood by a prior consideration of so-called over-the-counter transactions. In the latter, the holder of the check is a customer of the drawee bank and deposits the check in that bank, receiving either cash or credit. It is evident that when the depositor takes cash, the check is paid, and payment cannot be

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9. Sneider v. Bank of Italy, 184 Cal. 595, 194 Pac. 1021 (1920). An analogous situation was present in People v. Munday, 293 Ill. 191, 127 N.E. 364 (1920), a criminal case involving the trial of a bank official for receiving deposits knowing of the bank's insolvency. In the Sneider case the court held immaterial the fact that the drawee had mistakenly checked the wrong reason for returning the items. Inasmuch as the check has not been paid, the drawee may return it for any reason at all. Campbell v. Love, 168 Miss. 75, 150 So. 780 (1933) (drawer insolvent); Eastman Kodak Co. v. National Park Bank, 231 Fed. 320 (S.D. N.Y. 1916), aff'd without opinion, 247 Fed. 1002 (2d Cir. 1917) (mistake about instructions to pay).

10. Grosner v. First Nat. Bank, 5 F. Supp. 468 (E.D. Mich. 1933); Eastman Kodak Co. v. National Park Bank, 231 Fed. 320 (S.D. N.Y. 1916), aff'd without opinion, 247 Fed. 1002 (2d Cir. 1917); Campbell v. Love, 168 Miss. 75, 150 So. 780 (1933); Hentz v. National City Bank, 159 App. Div. 743, 144 N.Y. Supp. 979 (1st Dep't 1913). It should be noted that if a check has been paid by credit, the plaintiff's action is not upon the check, but upon the debt arising from the debtor-creditor relationship. See Aigler, Rights of Holder of Bill of Exchange Against the Drawee, 38 Harv. L. Rev. 857, 873 (1925); 80 U. of Pa. L. Rev. 740, 741 (1932).

11. The point is mentioned in the Hentz case, supra note 10.

revoked. But the clearing house transaction bears a closer resemblance to the over-the-counter credit transaction than to the cash transaction. In each of these credit routines, credit is given to the person presenting the check, and in each instance the drawee bank, having later discovered something the matter with the check, as, for example, that it is an overdraft, wishes to revoke the credit. Consequently, despite dissimilarities which will become apparent when the clearing house decisions are discussed, the over-the-counter credit transaction provides helpful background material in the solution of the clearing house cases.

It is to be noted that we are not dealing with the question of acceptance or certification of a check. Acceptance is a promise to pay, whereas the question with which we are concerned is whether the check has been paid. A lawsuit involving this question will not be brought upon the check, but rather upon the debt arising from the alleged payment of the check and the consequent debtor-creditor relationship between the bank and the presenting depositor.

When the check has finally been "paid," the drawee bank is not permitted to revoke the payment, although under certain conditions based for the most part upon mistake of fact, it may be entitled to reimbursement. On the other hand, if the acts performed by the bank fall short of payment, the bank has not become a debtor to the depositor and can successfully resist the latter’s claim. Thus, it becomes important to determine the point at which payment is effected.

Authorities have called attention to the confused state of the decisions concerning many of the questions relating to payment. Fundamentally, the question of whether payment by credit has occurred


14. Cases where checks are forwarded for collection and remittance are not analogous and will not be considered. The only "remittance" which the clearing house drawee makes is payment of its clearing house debit balance, if any, and that is based upon the provisional entries made at the time of the clearings and does not operate as payment of any particular check. Nor is the amount of the balance due affected by the subsequent discovery of some "not good" checks. The distinction between the remittance and credit cases is referred to in Hunt v. Security State Bank, 91 Ore. 362, 369, 179 Pac. 248, 251 (1919).


16. This matter will be treated subsequently. A frequent type of mistake of fact arises from a forged indorsement, believed by both parties to be genuine.

17. 2 Morse, BANKS AND BANKING 1217 (6th ed. 1928); Turner, Bank Collections—The Direct Routing Practice, 39 Yale L.J. 468, 479 (1930); Wallace, Comments on the Proposed Uniform Check Collection Code, 16 Va. L. Rev. 792, 803 (1930); 30 Ill. B.J. 157 (1941); 30 Mich. L. Rev. 962 (1932); Note, 15 A.L.R. 709 (1921).
depends upon the intent of the parties as manifested by their words and actions. This being so, it might be argued that the question is one of fact for the jury and therefore presents no problem of law at all. However, in questions of ultimate fact, as opposed to evidentiary facts, courts frequently adopt definite standards or rules, so that if certain facts are present, only one ultimate conclusion may be drawn. The question of payment of a check is admirably suited to this technique. Businessmen are entitled to as much certainty as possible in such an important matter. The bank and the depositor should not be forced to depend upon the vagaries of a jury, nor should they be subjected to the evil of divergent verdicts upon exactly the same facts. Fortunately, the courts tend to follow the suggested procedure in many of the payment problems, thus reducing to some degree of order an otherwise chaotic condition.

In the over-the-counter transaction, there is the following typical situation. The customer deposits the check in question, and receives credit in his passbook or on a deposit slip. Later in the day the bookkeeping department discovers that the drawer's account does not contain sufficient funds. The bank then attempts to revoke the credit. Most courts hold that the bank may not do so, since the facts constitute payment. It is said to be as truly a payment as though the bank had handed

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18. E. g., National Bank v. Burkhardt, 100 U.S. 686 (1879); Citizens State Bank v. Pritchett, 231 P.2d 462 (Colo. 1951); Oddie v. National City Bank, 45 N.Y. 735 (1871); 30 MICH. L. Rev. 962, 963 (1932); 80 U. OF PA. L. Rev. 740 (1932). In the Oddie case the court, at page 741, states the proposition in the following language: "In determining the legal effect of such transactions, we must apply the same rules applicable to all contracts and business affairs, and effectuate and carry out the intention of the parties, to be gathered from their acts and declarations, and the accustomed and understood course of the particular business."

19. This will be apparent from the subsequent discussion of what constitutes payment. For a good case wherein the court told the jury that under certain undisputed facts payment existed, see Bryan v. First Nat. Bank, 205 Pa. 7, 54 Atl. 480 (1903). Two cases indicating that payment is a question entirely for the jury are unsatisfactory in that they fail to point out the nature of the trial court's instructions to the jury. National Bank v. Burkhardt, 100 U.S. 686 (1879); Guardian Nat. Bank v. Huntington County State Bank, 206 Ind. 185, 187 N.E. 388 (1933). Any authority which the former case may have possessed on the point disappears in view of American Nat. Bank v. Miller, Agent, 229 U.S. 517 (1913) holding that certain facts operated as payment as a matter of law.

20. Of course, for a responsible drawer the bank may let the overdraft go through. In that case no problem arises. If the bookkeeper finds the account overdrawn, the check is often put "in suspense," with the idea that the drawer's account may be sufficiently increased during the day to cover the amount of the check. Another variation occurs where the drawer's account is sufficient to absorb the check, but is depleted during the day by the return of some "not good" items.

the money to the payee and immediately received it back as a cash deposit.\textsuperscript{22} Whether the deposit is in person or by mail is held to make no difference except that the latter type of deposit gives rise to the further controversy as to whether payment is complete upon mailing the notification or only upon the receipt thereof—a controversy which, despite its intriguing nature, need not be explored in this discussion.\textsuperscript{23}

One of the predominant reasons advanced for the majority rule is that the condition of the drawer's account rests within the knowledge of the drawee bank, and that if the bank has any misgivings on the subject, it should examine the account before delivering the passbook or deposit slip to the depositor. This view finds support in the following remarks of the court in \textit{Oddie v. National City Bank:}\textsuperscript{24}

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Gruber v. Bank of America, 127 Misc. 132, 215 N.Y. Supp. 222 (City Ct. 1926); Provident Sav. Bank & Trust Co. v. Hildebrand, 49 Ohio App. 207, 196 N.E. 790 (1934); accord, National Bank v. Burkhart, 100 U.S. 686 (1879); State \textit{ex rel.} Las Vegas v. Sandoval, 34 N.M. 50, 277 Pac. 31 (1929) (bank failure); Norton v. Mercantile Bank & Trust Co., 51 S.W.2d 1062 (Tex. Civ. App. 1932) (drawer's insolvency); see Federal Sav. & Loan Ins. Corp. v. Third Nat. Bank, 173 F.2d 192, 199 (6th Cir. 1949); Snyder v. Hamilton Nat. Bank, 65 Colo. 24, 30, 172 Pac. 1069, 1071, 1072 (1918); Brady, \textit{Bank Checks} § 260 (2d ed. 1926); 2 Morse, \textit{Banks and Banking} 1216 (6th ed. 1928); Note, 50 Col. L. Rev. 802, 818 (1950); 6 U. of Cln. L. Rev. 238 (1932); 80 U. of Pa. L. Rev. 740 (1932); Note, 15 A.L.R. 709 (1921). In some of the cases the bank's attempted revocation did not take place until \textit{after} the day of deposit, yet the \textit{ratio decidendi} was broad enough to include revocations attempted \textit{on} the day of deposit. American Nat. Bank v. Miller, Agent, 229 U.S. 517 (1913); Cohen v. First Nat. Bank, 22 Ariz. 394, 198 Pac. 122 (1921) (where, however, the court noted the possible distinction); American Exchange Nat. Bank v. Gregg, 138 Ill. 596, 28 N.E. 839 (1891); Bryan v. First Nat. Bank, 205 Pa. 7, 54 Atl. 480 (1903). Oddie v. National City Bank, 45 N.Y. 735 (1871), cited as a leading authority for the majority view, contains some factual variations which might justify the conclusion that it is not precisely in point. See the comments on the \textit{Oddie} case in National Gold Bank & Trust Co. v. McDonald, 51 Cal. 64 (1875). Since the check is paid by the entering of credit in the passbook, a subsequent stop payment order is ineffective, even though it arrives before the drawer's account has been debited. 24 Minn. L. Rev. 982 (1940).


23. For a "starter," see Cohen v. First Nat. Bank, 22 Ariz. 394, 198 Pac. 122 (1921) (mailing is sufficient); Guardian Nat. Bank v. Huntington County State Bank, 206 Ind. 185, 187 N.E. 388 (1933) (mailing is not sufficient, since postal regulations permit withdrawal from the mails); 47 Harv. L. Rev. 871 (1934); 80 U. of Pa. L. Rev. 740 (1932).

24. 45 N.Y. 735, 742 (1871).
The bank always has the means of knowing the state of the account of the drawer, and if it elects to pay the paper, it voluntarily takes upon itself the risk of securing it out of the drawer's account or otherwise.

No one will deny that theoretically the argument is sound. And in the simpler days of past generations there was doubtless no element of unfairness in adhering to the rule. In many parts of the country the banking business had not reached the highly complex state existing today. The banker and his clerks (if any) were well acquainted with the depositors, and usually knew the condition of each one's account. If perchance the latter piece of information was lacking, the banker or his clerk could look it up in a moment, and there was seldom a line of depositors who would be kept waiting during such an investigation.\(^2\) As late as 1919, an Oregon case presents a picture of the simplicity of small-town banking. When the morning mail arrived, the president of the bank footed the checks on the adding machine to see that each total corresponded with the cash letter, and examined them for signatures and state of account.\(^3\)

How vastly removed are those halcyon days from the present high-blood-pressure era when a bevy of tellers are kept busy handling long lines of customers. Imagine the reaction of the impatient horde if an examination must be made of all the checks presented to the teller by each depositor, in order to ascertain the genuineness of every check and the state of account of every drawer. The resulting delay would be interminable and would probably cause a caterwauling audible blocks away and even loud enough to permeate the sound-proof sanctum of the bank's president. How long would such a bank be able to retain its customers? And what about the morale of the bookkeepers, trying manfully to get along with the job of posting debits and credits to the various accounts, if their work is constantly interrupted by tellers inquiring about the genuineness of each check and the state of account of each drawer?

No, the "majority" rule, which, after all, grew up in a more tranquil age, does not conform to the complexities of modern banking. Today, the teller must enter the credit immediately, either in the passbook or on a duplicate deposit slip, and permit the customer to move on to make way for the next person. To hold that such a credit constitutes payment and is irrevocable places an undue burden upon the bank.

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25. This picture of the past was obtained from several banking officials who have worked in the business for forty years or more.

More realistic and equitable are the California decisions, taking a position exactly opposite to that of the majority. In *National Gold Bank and Trust Company v. McDonald*, the depositor presented his check and passbook at 2 p.m. The teller received the check and entered the proper credit in the passbook. At 3 p.m., the bank, having found the drawer's account insufficient, returned the check and notified the depositor that it was not good. In a suit by the depositor against the bank, the trial court rendered judgment for the plaintiff upon the ground that the item was presented and received as a cash deposit. The Supreme Court reversed the judgment, holding that the finding was not supported by the evidence and adopting the rule that under the facts enumerated, the check was not received as cash, but merely for collection. Under this theory the drawee takes the item as agent to collect from itself, and the credit may be revoked exactly as in the case of an uncollected item drawn on another bank. The acts are definitely held to fall short of payment.

It should be noted that in the cases upholding the majority rule no evidence was presented indicating or implying an agreement allowing the bank to revoke the credit. If, on the other hand, the bank is able to prove the existence of a custom permitting the revocation of a credit upon discovery during the day that the check is not good, the depositor should be bound by the custom, at least if he was familiar with it. Payment depends upon the intent of the parties. In the absence of contradictory evidence, they should be presumed to have dealt in accordance with a custom known to both. And there is authority for extending

27. 51 Cal. 64 (1875).

28. The rule was announced again some years later, the court also holding that the situation was not altered by stamping the check "Paid", impaling it on the check file, and crediting it to the depositor's ledger account. Ocean Park Bank v. Rogers, 6 Cal. App. 678, 92 Pac. 679 (1907). The California rule is approved in Stankey v. Citizens' Nat. Bank, 64 Mont. 309, 209 Pac. 1054 (1922). The act of stamping the check "Paid" seems not to be considered of any importance. Cohen v. First Nat. Bank, 22 Ariz. 394, 198 Pac. 122 (1921) (check not stamped; court held payment); Guardian Nat. Bank v. Huntington County State Bank, 206 Ind. 185, 187 N.E. 388 (1933) (check not stamped; held no payment, but decision reached on other grounds); Ocean Park Bank v. Rogers, 6 Cal. App. 678, 92 Pac. 879 (1907) (check stamped; held not paid). In the following cases the court, in holding that the check was paid, gave no consideration to the fact that it had been stamped "Paid": American Exchange Nat. Bank v. Gregg, 138 Ill. 596, 28 N.E. 839 (1891); Consolidated Nat. Bank v. First Nat. Bank, 129 App. Div. 538, 114 N.Y. Supp. 308 (1908), aff'd without opinion, 199 N.Y. 516, 92 N.E. 1081 (1910); Bryan v. First Nat. Bank, 205 Pa. 7, 54 Atl. 480 (1903). Since the stamping or cancellation of the check is merely part of the clerical routine of the bank, and may take place before the drawer's account has been examined, the courts are correct in attaching no significance to it. However, I am informed by bank officials that at present the canceling of the checks (they are run through a perforating machine) is customarily the last act of the routine, and does not occur until after the examination of the drawer's account.

29. First Nat. Bank v. Ihle, 202 Ark. 46, 149 S.W.2d 548 (1941); First Nat. Bank v. McKeen, 197 Ark. 1060, 127 S.W.2d 142 (1939) (holding evidence insufficient to
this proposition to include the case of a depositor who has no knowledge of the custom, provided he ought to have known of it.\textsuperscript{30} Such an extension of the doctrine seems eminently fair. A person dealing with banks should be subject to all reasonable banking usages.\textsuperscript{31} No hardship results to the depositor, for in reality, most depositors never heard of the rules of law concerning payment by credit, and do not make deposits with any such issue in mind.\textsuperscript{32} Any depositor aware of the problem can very easily evidence his intent by express agreement or other form of manifestation.

At the present time banks customarily resort to recitals on signature cards, passbooks, and deposit slips to regulate the legal relationship between themselves and their customers in the collection of checks. Assuming for the moment that such recitals constitute a contract and therefore are binding upon the depositor, it becomes necessary for the court to interpret them. Inasmuch as the more pressing problems have arisen out of the collection of checks drawn on banks other than the depository bank, many of the recitals are so worded as apparently to apply only to such checks. Thus, for example, in an Illinois case, the deposit slip provided: "All items received . . . for deposit are credited subject to final payment, reserving the right to charge back any items not paid." The court held that this clause referred only to checks drawn on other banks, and could not logically be interpreted to include checks drawn on the bank of deposit.\textsuperscript{33}

A Louisiana court reached the same conclusion in a case wherein the back of the deposit slip contained the following paragraph:

All items credited subject to final payment. All items not payable in Haynesville received by this bank for credit or collection are taken at the owner's risk.

prove a custom known to depositor); Pollack v. National Bank of Commerce, 168 Mo. App. 368, 151 S.W. 774 (1912) (estoppel to deny intention to be bound by a known custom); \textit{Brady, Bank Checks} § 260 (2d ed. 1926).


32. Of course it may be argued that when the depositor hands in his checks and receives credit in his passbook, his understanding of the transaction is that the amount credited has become part of his account, for which reason the credit should be irrevocable in the absence of knowledge of the contrary custom.

33. Hay and Stephens v. First Nat. Bank, 244 Ill. App. 286 (1927). For a very restricted interpretation of a clause providing that in receiving items for deposit or collection, the bank acts only as agent, see Andrew v. Security Trust & Sav. Bank, 214 Iowa 1199, 243 N.W. 542 (1932) (a five to four decision).
There followed a provision concerning the responsibility assumed by the bank in forwarding items to collecting agents outside of Haynesville.\textsuperscript{34}

On the other hand, the deposit slip or other pertinent document may specifically include checks drawn on the bank of deposit, in which event the courts cannot logically make an interpretation to the contrary.\textsuperscript{35} Indeed, at the present time the standard collection agreement, issued by the American Bankers Association, contains such a provision,\textsuperscript{36} and the great majority of banks are probably making use of it and thereby avoiding difficulties of interpretation arising from "foggy" language.\textsuperscript{37}

Whether recitals on signature cards, passbooks, or deposit slips constitute a contract is a perplexing problem, the definite solution of which, if any there be, lies outside the scope of this discussion. Apparently the mere presence of the recital does not suffice. In some way it must be brought to the attention of the depositor, although he need not actually have read it.\textsuperscript{38} Naturally, if a contract has been created, the depositor is bound by its terms.

The most satisfactory manner of solving the problem of revoking credits is by statute, and Section 3 of the Bank Collection Code puts an end to the controversy in the states of its adoption. The section reads:

37. In a Minnesota case the agreement permitted the bank to charge back any item drawn on it and later found to be not good. Plaintiff made a deposit, the amount of which was credited to him in his passbook. Thereafter, a stop payment order arrived at the bank. The court, held that under the agreement the bank had no right to charge back the amount of the check, inasmuch as it did not fall within the term "not good." The check was perfectly good, decided the court, and the stop payment order did not make it a "not good" check. W. A. White Brokerage Co. v. Cooperman, 207 Minn. 239, 290 N.W. 790 (1940).
38. E. S. Macomber & Co. v. Commercial Bank, 166 S.C. 236, 164 S.E. 596 (1932) (using the same form of deposit slip for over a year held sufficient); Hardee v. George H. Price Co., 89 F.2d 497 (D.C. Cir. 1937) (deliberately choosing a particular form of deposit slip); see Brady, Bank Checks § 267 et seq. (2d ed. 1926). In Lebanon Bank & Trust Co. v. Grandstaff, 24 Tenn. App. 162, 141 S.W.2d 924, cert. denied (1940), the court indicated that the mere use of the deposit slip was sufficient, but probably did not intend to go that far, for it cited in support of its opinion the Macomber and Hardee cases, supra this note, neither of which adopted such an extreme position. However, an Arkansas case appears to go all the way. First Nat. Bank v. Ihle, 202 Ark. 46, 149 S.W.2d 548 (1941). And in a recent Colorado case the court holds without debate that the provisions on the signature card, signed by the depositor at the time of the opening of his account, constitute a contract. Citizens State Bank v. Pritchett, 231 P.2d 462 (Colo. 1951). At the other extreme is First Nat. Bank v. Hancock, 60 S.W.2d 871 (Tex. Civ. App. 1933), containing language to the effect that a deposit slip is not a contract and that a depositor is not subject to its terms unless he expressly ratifies them.
A credit given by a bank for an item drawn on or payable at such bank shall be provisional, subject to revocation at or before the end of the day on which the item is deposited in the event the item is found not payable for any reason. Whenever a credit is given for an item deposited after banking hours such right of revocation may be exercised during the following business day.  

The statute is in line with the California cases and effectuates a result conformable to modern business practice.  

In states which held that an entry on a deposit slip or in a passbook did not amount to final payment, and in states where the issue had never been litigated, the question sometimes arose as to what other acts or combination of acts were sufficient to constitute final payment, precluding a cancellation of the credit.  

In the days of comparatively simple bookkeeping, the banker kept a journal in which he entered each item of the day's business. These entries were eventually "posted" in the general ledger. Today, banks do not keep such daily journals, and the entries are made directly in the general ledger. However, many banks keep a "check journal," on which the amount of each check received is listed and the total arrived at; and a "general cash sheet," for the purpose of showing the bank's cash condition. It seems clear that entries on these documents, in no way intended as a record of the individual accounts of the depositors, should not be considered as payment.  

Nothing else appearing, the combination of crediting the depositor's account and debiting the drawer's account has been held to constitute final transfer of the credit from the drawer to the depositor, and therefore to amount to payment. Under this view, the transaction is irre-
vocable and the book entries cannot be reversed even though the bookkeeper later finds that he has made a mistake in the amount on deposit in the drawer's account, or that some of the checks credited to the account have "bounced," or that the drawer's signature was forged, or that the drawer has become insolvent. Likewise, a stop payment order or an order of attachment comes too late to be effective.\textsuperscript{43}

Section 3 of the Bank Collection Code does not state expressly the effect of debiting the drawer's account. But, as noted, the section permits the bank to revoke the credit during the day of deposit "in the event the item is found not payable for any reason." Since nothing is said about debiting the drawer's account, presumably it is regarded as a matter of no significance and will not preclude the revocation of the credit.\textsuperscript{44}

Turning now to the clearing house cases, it is apparent that an act falling short of payment in a non-clearing house case will not operate as payment in a clearing house case. Thus, for example, the mere fact that the check was stamped "paid" will not prevent cancellation of the "payment" and return of the item.\textsuperscript{45}

It has been pointed out that many of the payment cases involving direct presentment deal with a deposit by the customer, a credit entered in his passbook, or on a deposit slip, and a subsequent attempt by the bank to revoke the credit. The clearing house cases do not raise the exact issue presented by those bare facts. That is because, as already noted, it is definitely established that the credits entered at the clearing house are intended to be provisional only and do not amount to payment. And no other individual credits are made in favor of any particular presenting bank.\textsuperscript{46}

\textsuperscript{43} Albers v. Commercial Bank, 9 Mo. App. 59 (1880) (stop payment order). Although a clearing house was involved, the case should be classified with the non-clearing house material, because the "return" custom did not embrace checks upon which payment had been stopped.

\textsuperscript{44} Section 7 of the Bank Collection Code, dealing with deposits received by mail, states that where the item is received by mail by a solvent drawee bank, it shall be deemed paid when the amount is finally charged to the account of the maker or drawer.\textsuperscript{45} Grosner v. First Nat. Bank, 5 F. Supp. 468 (E.D. Mich. 1933) (clearing house stamp); Akron Scrap Iron Co. v. Guardian Sav. & Trust Co., 120 Ohio St. 120, 165 N.E. 715 (1929) (drawee's stamp); Hall v. First Nat. Bank, 252 S.W. 828 (Tex. Civ. App. 1923), modified, 254 S.W. 522 (1923) (clearing house stamp; modification on another point); Fernandez v. Glynn, 1 Camp. 426 n., 170 Eng. Rep. 1009 n. (1807) (drawee's stamp).

\textsuperscript{45} In a city which settles clearing house balances by entries on the books of the local federal reserve bank, a drawee bank showing a debit balance for the day's
Consequently, the only problem causing any difficulty arises when the drawee bank debits the drawer’s account, and later wishes to cancel the entry, treat the check as dishonored, and return it to the presenting bank within the time stipulated by the clearing house rule. In debiting the drawer’s account, the bank has performed an act which ordinarily is considered payment. But the banks, by rule, have agreed that items may be returned before a certain hour. Since payment is a matter of intent, and the parties have set down their intent in the rules of the clearing house, the solution of the problem becomes merely a matter of interpretation of the rule. In this respect the situation is similar to that involving printed recitals in passbooks and deposit slips, agreed to by the depositor.

An examination of a number of clearing house rules reveals that the terms in most general use are “not good” items, “not paid” items, “dishonored” items, and “unpaid” items. For the return of such items by a certain time, the typical clearing house rule makes provision. It follows that the term “not good” items, or whichever other appellation the clearing house in question may employ, must be interpreted.

It may conceivably be argued that a “not good” or “not paid” item means only an item which never has been charged against the drawer’s account, by reason of the discovery of a shortage of funds, forgery, or the like. The argument gains in plausibility when it is recalled that checks are inspected for irregularities, omissions, forgeries, and other defects before being entered in the general ledger, and that the bookkeeper examines the state of the drawer’s account before making his entry. As a consequence, the item might be regarded as “good” or “paid” when, after successfully completing the several tests, it is finally charged against the drawer. Yet this interpretation seems to overlook the fundamental purpose of the rule, which is to permit the banks to wait until a certain time before finally deciding whether to honor or dishonor the items presented. Had the banks wished to make the debiting of the drawer’s account the last “rite,” they could easily have said so in clearings credits the amount thereof in its general ledger to the reserve bank. This does not amount to payment of any particular check, for the clearing house balances are arrived at solely on the basis of the provisional debits and credits made at the clearing.

47. In addition, many clearing houses include missent items, irregular items, and others. For further information about methods of dealing with return items, see Andrews, The Operation of the City Clearing House, 51 Yale L.J. 582, 598 (1942).

48. The Buffalo rule reads as follows: “Dishonored Items. All checks . . . or other items presented for payment through the Clearing House which are rejected shall be returned through the regular morning exchanges of the next succeeding business day.”

The Detroit rule provides: “Unpaid items may be returned in any Exchange not later than the 2:00 P. M. Returned Item Exchange of the following business day.”

These are given as examples. Many of the rules are much more detailed.
their rule. In the absence of a provision to that effect, the rule should be interpreted to mean that the check is not paid until the expiration of the return period.49

The banks themselves place this interpretation upon the terms used.50 And it is familiar law that parol evidence is admissible to explain the meaning of terms peculiar to the trade or business in which the contracting parties are engaged. Consequently, if the banks interpret the phrase "not paid" as permitting the return of an item even after the drawer's account has been charged, such an interpretation should be determinative.

The practical importance of the question is best illustrated by an enumeration of several possibilities which may occur after the bookkeeper has debited the drawer's account.

1. The bank receives word that the drawer's signature is forged.
2. The bank finds that since the debiting of the account, checks have been cashed over the counter to an amount sufficient to make the check in question an overdraft.
3. The bank finds that some of the items standing to the drawer's credit have been returned "not good," as a result of which the check has become an overdraft.
4. The bookkeeper finds that he has made a mistake in the amount on deposit, as a consequence of which the check is an overdraft.
5. The bank learns that the drawer, who owes the bank on a note, has become insolvent.
6. A stop payment order arrives.
7. An order of attachment arrives.
8. An irregularity in the check is discovered, as, for instance, that it is postdated.61

Under all these conditions, and others like them, banks permit the return of the item as not paid or not good.62

The reported cases dealing with the matter under consideration are few and, for the most part, unsatisfactory. Doubtless the paucity of authorities bespeaks the practical effectiveness of the clearing house rule.

49. Furthermore, it would be impracticable—in fact, impossible—to wait until the expiration of the "return" time before allowing the bookkeepers to commence their task of making the entries. For this reason, also, the debiting of the drawer's account should not be considered final payment.

50. A number of bank officials supplied this information.

51. Under a clearing house rule specifically including "irregular" items, the debiting of the drawer's account should have no effect at all in the case of such an item. It is as irregular after the debit entry as before.

52. For a criticism of the solution of diverse problems by one "payment" concept, see Leary, Deferred Posting and Delayed Returns—The Current Check Collection Problem, 62 Harv. L. Rev. 905, 946-952 (1949).
in action. In several instances the court reaches its conclusion without reference to the clearing house rule, holding, for one reason or another, that the rules of the association do not apply under the particular circumstances.\(^5\) There are dicta to the effect that no payment occurs until the expiration of the time allowed for the return.\(^6\) But the only case found which may be called directly in point is *German National Bank v. Farmers' Deposit National Bank*.\(^5\) Even there, the only acts performed by the drawee bank consisted of placing the check on a file and entering it in a journal—acts which would not be considered payment anyhow. However, the decision was placed squarely upon the ground that whether or not the acts would have constituted payment in an over-the-counter transaction, the clearing house rule prevented their amounting to payment until the expiration of the return period.

An Ohio case hits close to the mark, but the basis of the decision is not entirely clear.\(^6\) The only act of the bank was stamping the check "Paid." As previously noted, this does not amount to payment and the court so decided. But the court held also that evidence of the rules and customs of the clearing house relating to returns should have been admitted. In view of that ruling, one might argue that the court intended to base its decision on two points; namely, that the stamping was not payment, and that in any event no payment took place until the time limit had expired. If the court did not so intend, it is difficult to understand the relevancy of the clearing house rules and they should not have been admitted in evidence.\(^5\)

Another case cited on the point proves a great disappointment when the facts are analyzed.\(^5\) After the bookkeepers had charged the check

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\(^5\) There is no need to cite these decisions here. They have been included, where applicable, among the non-clearing house authorities.

\(^6\) Eastman Kodak Co. v. National Park Bank, 231 Fed. 320, 324 (S.D. N.Y. 1916), *aff'd without opinion*, 247 Fed. 1002 (2d Cir. 1917); Security-First Nat. Bank v. Bank of America Nat. Trust & Sav. Ass'n, 22 Cal.2d 154, 161, 157 F.2d 452, 456 (1945); Campbell v. Love, 168 Miss. 75, 84, 150 So. 780, 782 (1933); Hentz v. National City Bank, 159 App. Div. 743, 746, 144 N.Y. Supp. 979, 981 (1st Dep't 1913). (In these cases the facts did not show that the drawee had made any entries.) But see United States Fidelity & Guaranty Co. v. First Nat. Bank, 129 Neb. 102, 109, 260 N.W. 798, 801 (1935). In support of its dictum the court cited First Nat. Bank v. National Park Bank, 100 Misc. 31, 165 N.Y. Supp. 15 (Sup. Ct. 1917), which, apparently unbeknown to the court, was reversed in 181 App. Div. 103, 168 N.Y. Supp. 422 (1st Dep't 1917), and in which the debit entry was only "tentative."

\(^5\) 118 Pa. 294, 12 Atl. 303 (1888).

\(^6\) Akron Scrap Iron Co. v. Guardian Sav. & Trust Co., 120 Ohio St. 120, 165 N.E. 715 (1929).

\(^5\) It is interesting to note that plaintiff's petition alleged that the bank debited the drawer's account. Defendant's denial made this an issue, but we hear nothing more about it in the opinion. Presumably, the plaintiff offered no proof on the subject.

to the drawer's account, they were informed of a stop payment order. In holding that the check had not been paid, the court gave every indication of being in line with the correct rule. However, a careful investigation of the facts reveals that the stop payment order apparently reached the bank before the checks had arrived from the clearing house. Consequently, its arrival was in ample time. And the court stated merely that the order was received by the drawee in time to be effective. Was it effective because it arrived before the debiting of the account, or because the period for returning dishonored items had not passed?69

Despite the fact that dictum predominates over decision, and that in some instances the decisions are not clear-cut, it seems correct to conclude that payment does not take place until the expiration of the time allowed for returning items, and that this is true despite the performance by the bank of acts which would constitute payment in an over-the-counter transaction.60

In states which have adopted the Bank Collection Code the question of the applicability of Section 3 to clearing house transactions is presented. As previously stated, Section 3 provides that a credit given by a bank for an item drawn on the same bank shall be provisional and subject to revocation at or before the end of the day of deposit. As remarked by Mr. Wallace, "In one sense of the word the tentative settlement in the clearing house is a credit given by the bank for the check."61 However, Section 3 was not conceived for the purpose of meeting any problem connected with the clearing house. Its purpose was to overthrow the majority rule established for over-the-counter transactions, which unjustifiably prohibited the bank from revoking a credit once given. The clearing house associations had already taken care of the problem by the adoption of the rule relating to returns. Furthermore, even if the language of the section is broad enough to cover clearing houses, there is nothing to forbid their making their own agreement with reference to returning items, and that agreement would prevail despite the statute, if not in conflict with it.

59. The case is further complicated by the fact that the plaintiff bank did not claim that the check was paid; instead, the claim was advanced by the defendant drawer, who had ordered payment stopped.

60. But see Wallace, Comments on the Proposed Uniform Check Collection Code, 16 Va. L. Rev. 792, 805 (1930). Mr. Wallace states that the cases are in disagreement as to whether a check charged to the drawer's account thereby becomes paid so as to prevent its return during the period stipulated by the clearing house rule. He cites two cases, neither of which is in point.

61. Id. at 804. For the applicability of clearing house rules to nonmembers, see Andrews, The City Clearing House: Problems Concerning Nonmembers, 2 Western Res. L. Rev. 109 (1950).
Although the termination of the period prescribed by the clearing house for the return of items may be said in general to operate as payment, a complication arises from the fact that banks sometimes accept late returns and refund the amount to the drawee. Indeed, the practice appears to be common, although ordinarily limited to items returned on the specified day but after the specified hour. Certainly there is no reason for the law to deny banks this right as among themselves. If a customer wishes to allow his bank to revoke a credit entered in his passbook, the courts should not forbid his doing so. And the acceptance of a late return by the presenting bank is analogous.\(^6^2\)

As might be expected, there are few decisions upon the subject. All of them recognize the right. A brief statement of the facts in each case will throw light on the proposition, by indicating how the question has arisen.

In *Stuyvesant Bank v. National Mechanics' Banking Association*\(^6^3\) plaintiff bank was not a member of the clearing house, but cleared through the *M* bank, its clearing agent. Plaintiff bank sent some checks to the *M* bank, which presented them through the clearing house. The checks were paid. A few days later the drawee discovered that they were forged. Contrary to clearing house rules, the drawee sent them back through the clearing house. *M* bank allowed them to go through, charged the amount back against plaintiff, and returned the checks to plaintiff. Plaintiff obtained an assignment from the *M* bank of its alleged claim against the drawee, and sued the drawee for the amount of the items. In an opinion not distinguished for its lucidity, the court correctly held in favor of the defendant, remarking that it was competent for the *M* bank to waive the delay in returning the paper.

*Corn Exchange Bank v. Fifth National Bank*\(^6^4\) presents the issue in a slightly different setting. After the “zero” hour for returning checks, the drawee told the presenting bank that the drawer’s account did not contain sufficient funds. The presenting bank accepted the return and reimbursed the drawee. Thereafter, the latter discovered that the drawer’s signature had been forged. This information the drawee passed along to the presenting bank. A few days later the presenting bank, hoping perhaps to catch the drawee napping, put the check through again. This time the drawee returned the check in accordance with the rule, but the presenting bank refused to accept the return or refund the amount, stating that had it known of the forgery, it would never have

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\(^6^2\) See *supra* note 61 with reference to nonmembers.

\(^6^3\) 7 Lans. 197 (N.Y. 1872).

\(^6^4\) 123 Misc. 328, 205 N.Y. Supp. 777 (N.Y. City Ct. 1924).
accepted the return the first time. The drawee thereupon sued the presenting bank and recovered, the court pointing out that the presenting bank was competent to waive the rule requiring returns to be made by a certain time, and had done so unconditionally in this instance.

The most interesting application of the right to waive is to be found in In re Smith, Lockhart and Co. The presenting banks accepted several items returned late, and made the usual refund to the drawee. Shortly before the returns, a bankruptcy petition had been filed against the drawer. This, however, the drawee did not know. Some days later the drawee, knowing of the bankruptcy proceedings and the appointment of a receiver for the drawer, repaid the amount to the presenting banks, upon the theory that the drawee had not been entitled to the refunds. The drawer's trustee in bankruptcy sued the drawee for the amount of the deposit represented by the returned checks. The trustee contended that the bank's payment, made with knowledge of the bankruptcy proceedings and the appointment of a receiver, was wrongful. The drawee countered with the argument that it had no legal right to the refunds, and therefore was obliged to reimburse the presenting banks. The court decided that the presenting banks had acted within their rights in accepting the late returns and reimbursing the drawee, as a consequence of which the drawee was not obligated to pay back the amount to the presenting banks. Since it was not so obligated, the payment, made with knowledge of the receivership, was wrongful.

Other problems occasionally arise after the expiration of the time limit for returning "not good" checks. Some of them are easy to solve insofar as the clearing house aspect is concerned. The simplest involves forged indorsements. Entirely apart from any clearing house aspect, the courts permit recovery by the paying bank from the person who has received payment of a check upon which an indorsement in the chain of title has been forged. By reason of the forged indorsement, unknown to either party, payment has taken place under a mistake of fact—a familiar ground for allowing recovery. It has also been suggested that recovery is based upon a guarantee by the person presenting the item for

65. 4 F.2d 444 (D. Md. 1924).
66. The model deferred posting statute, which will be considered later, provides for variation of its "effect" by agreement. Does that permit waiver of the statutory deadline?
67. BRADY, BANK CHECKS § 165 et seq. (2d ed. 1926); BRITTON, BILLS AND NOTES 641-650 (1943); 2 MORSE, BANKS AND BANKING § 476 (6th ed. 1928); WOODWARD, QUASI CONTRACTS, § 80 et seq. (1913); Note, 50 Col. L. Rev. 802, 823 (1950). This paper is not concerned with exceptions to and modifications of the rule. Apparently standing alone is a case wherein the court allowed the drawee bank to recover one-half the amount of the check. Capital City Bank v. Lewis State Bank, 143 Fla. 768, 197 So. 528 (1940), 7 U. of Pitt. L. Rev. 136 (1941).
payment that all prior indorsements are genuine. But the Negotiable Instruments Law gives no justification for this latter line of reasoning. It is true that by Section 66 one who indorses without qualification warrants that he has good title to the instrument. It is equally true that one who takes through a forged indorsement does not have good title to the instrument. However, Section 66 specifies that the warranties enumerated run "to all subsequent holders in due course", and by no stretch of the imagination can the drawee, in receiving and paying the check, be included in the favored category. Likewise, Section 65 applies only to persons "negotiating" the instrument, and a presentation to the drawee for payment is not a negotiation.

Since the principle of recovery of money paid under mistake of fact assumes that the money has been actually paid, it is manifest that recovery may be had in clearing house as well as non-clearing house cases. When the time for returning an item has expired, the item is treated as paid, and the parties stand in the same position as though payment had been made across the counter. The return time rule was not intended to interfere with well-recognized principles of law relating to recovery of money already paid. Indeed, the proposition is so obvious that in the clearing house cases the courts, in upholding the right to recover, make no mention of the return time rule.

In clearing house transactions recovery may be based also upon an express guarantee by the forwarding bank to the drawee bank of the genuineness of prior indorsements. It is customary for clearing house associations to provide for an indorsement stamp to be affixed upon each item by the presenting bank. The regulations of a number of associations—probably the majority—require that the words "Prior endorsements guaranteed" shall be an integral part of the stamp. Some associations, while not including those words in the prescribed stamp, stipulate that the stamped indorsement of itself shall constitute a guarantee of all prior indorsements. Others, in an excess of caution, do both.

69. The same warranty is created by a qualified indorsement. NEGOTIABLE INSTRUMENTS LAW §65.
70. NEGOTIABLE INSTRUMENTS LAW §23.
71. BRITTON, BILLS AND NOTES 644 (1943); 6 INTRAMURAL L. REV. OF NEW YORK UNIVERSITY 198, 199 (1951). By §4 of the Bank Collection Code, adopted in some states, the restrictive indorser guarantees to the drawee the genuineness of prior indorsements.
If, by either the stamp or the regulation, prior indorsements are guaranteed, it is clear that the guarantee will enable the drawee to recover the amount paid. The situation is not like the one resulting from Section 66 of the Negotiable Instruments Law, where, as already noted, the guarantee goes only to a holder in due course. Since the items sent through the clearing house are presented to the drawee only, the guarantee imposed upon the presenting bank must be intended to inure to the benefit of the drawee—otherwise it would be without any force at all.

A number of the associations specify that the guarantee shall not supply the place of a missing indorsement. In Merchants National Bank v. Continental National Bank, defendant advanced the absurd argument that a forged indorsement was a missing indorsement, and therefore, not covered by the guarantee. Were such an argument to prevail, the guarantee of prior indorsements would be meaningless; and the court made short work of the matter, holding that the provision relating to missing indorsements referred not to invalid indorsements but to cases where there was no indorsement at all.

The principle permitting recovery of money paid under mistake of fact extends to paper which has been wrongfully altered, as, for instance, by raising the amount payable. As in the case of the forged indorsement, the clearing house regulations limiting the time for returning not good items have no application to the recovery of money paid on altered instruments, and courts permit recovery without mention of any such regulations.

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74. 98 Cal. App. 523, 277 Pac. 354 (1929).

75. BRADY, BANK CHECKS § 143 (2d ed. 1926); BRITTON, BILLS AND NOTES § 140 (1943); 2 MORSE, BANKS AND BANKING § 479 (6th ed. 1928); WOODWARD, QUASI CONTRACTS § 80 (1913); Note, 50 Col. L. Rev. 802, 823 (1950). Under the Negotiable Instruments Law there is conflict among the authorities. The problems are beyond the scope of this article. For an argument against recovery even at common law, and a suggested distinction from the forged indorsement case, see Ames, The Doctrine of Price v. Neal, 4 Harv. L. Rev. 297, 306 (1891).

76. Interstate Trust Co. v. United States Nat. Bank, 67 Colo. 6, 185 Pac. 260 (1919) (recovery based on theory of indorser's guarantee); Imperial Bank v. Bank of Hamilton, [1903] A. C. 49. The right to recover is recognized also in Continental Nat. Bank v. Tradesmen's Nat. Bank, 173 N.Y. 272, 65 N.E. 1108 (1903), where, however, recovery was denied by reason of the drawee's negligence.
Recovery was denied in an important California case, upon the ground that the clearing house stamp, guaranteeing the validity of all prior indorsements, did not amount to a guarantee against alteration.\textsuperscript{77} It is clear, however, that in a situation and jurisdiction where the drawee bank is allowed to recover an overpayment on an altered instrument, a clearing house stamp guaranteeing prior indorsements should not preclude recovery. The use of such a stamp in order to ensure recovery in the case of a forged indorsement does not indicate an intention to deny recovery in the case of an altered instrument.\textsuperscript{78}

The principle of recovery by reason of mistake of fact does not extend to the forgery of the drawer's signature.\textsuperscript{79} Without delving deeply into the various theories behind this rule, it is enough to point out that the drawee bank is bound to know the signature of every depositor, and guarantees the genuineness thereof. When the drawee bank sues to recover money paid under a mistaken belief in the validity of the drawer's signature, it encounters and bows to the judicially imposed guarantee.

We have already seen that before the expiration of the clearing house return time the drawee bank may send back a check upon which the signature of the drawer has been forged. After the return time has passed, the check received through the clearing house stands upon the same footing as any other check which the drawee has paid. It follows that, by the weight of authority, the drawee, upon subsequently discovering the forgery, has no cause of action against the recipient for recovery of the amount paid.\textsuperscript{80}

\textsuperscript{77} Crocker-Woolworth Nat. Bank v. Nevada Bank, 139 Cal. 564, 73 Pac. 456 (1903). The decision was based also upon other grounds.
\textsuperscript{78} See 20 Banking L. J. 573 (1903).
\textsuperscript{79} Brady, Bank Checks § 152 et seq. (2d ed. 1926); Britton, Bills and Notes 613-634 (1943); Woodward, Quasi Contracts § 80 et seq. (1913); Ames, 'Th. Doctrine of Price v. Neal, 4 Harv. L. Rev. 297 (1891); 24 Banking L. J. 947 (1907) Note, 50 Col. L. Rev. 802, 822 (1950); 15 Tulane L. Rev. 468 (1941). Here again, since our concern is with the clearing house, there is no need to elaborate. Dean Ames favored the general rule upon the ground that courts should not interfere between persons having equal equities, but should let the loss lie where it has fallen.
\textsuperscript{80} Security Commercial & Sav. Bank v. Southern Trust & Commerce Bank, 74 Cal. App. 734, 241 Pac. 945 (1925) (slightly weakened as a direct authority by various factors discussed by the court); National Bank of Commerce v. Mechanics' American Nat. Bank, 148 Mo. App. 1, 127 S.W. 429 (1910) (in which, however, the court erroneously used as an alternative ground of decision the fact that check was not returned within clearing house time limit); United States Fidelity & Guaranty Co. v. First Nat. Bank, 129 Neb. 102, 260 N.W. 798 (1935) (also erroneously using late return as alternative ground for decision); First Nat. Bank v. United States Nat. Bank, 100 Ore. 264, 197 Pac. 547 (1921) (included point that clearing house indorsement stamp does not warrant genuineness of drawer's signature); Minnehaha Nat. Bank v. Pence Pharmacy, 42 S.D. 525, 176 N.W. 37 (1920) (stating obvious truth that payment through clearing house does not affect general rule).
Where, however, the recipient has not changed its position and would suffer no loss if compelled to repay, there is authority granting recovery.\textsuperscript{81} As in the forged indorsement cases, the clearing house return rule is entirely irrelevant.\textsuperscript{82}

Of course there is nothing sacrosanct about the principle involving the drawee's guarantee of the genuineness of the drawer's signature, and the legislature has a perfect right to scrap the rule and allow recovery if it so desires. This it did in Pennsylvania, although the adoption of the Negotiable Instruments Law has long since repealed the earlier statute. Under such a statute the drawee obtained reimbursement, and, as in other situations previously discussed, the clearing house return time rule had nothing to do with the proceeding.\textsuperscript{83}

If the drawee makes payment under the mistaken belief that the drawer's account is sufficient, recovery from the innocent purchaser for value is generally denied.\textsuperscript{84} And there are clearing house cases in accord.\textsuperscript{85}

The argument for the defendant is even more persuasive than in the forged instrument situation, for whereas the forger may have performed his task so deceptively as to confound the most meticulous employee, the amount of the drawer's balance is ordinarily ascertainable by the employees of the bank.

Reverting to the situation in which the clearing house return time rule applies and in which the deadline for the return of items must be

\textsuperscript{81} Only the cases involving payment through the clearing house are given. First State Bank & Trust Co. v. First Nat. Bank, 314 Ill. 269, 145 N.E. 382 (1924) (not mentioning clearing house return rule, thus implying that it was irrelevant); National Bank of Baltimore v. Drovers and Mechanics Nat. Bank, 143 Md. 168, 122 Atl. 12 (1923). (forged certification, but principle same as forged drawer's signature; decision based somewhat on interpretation of clearing house rule); Metropolitan Trust Co. v. Federal Trust Co., 232 Mass. 363, 122 N.E. 413 (1919) (court pointed out that clearing house rule was inapplicable and that situation was same as where check paid over counter); National Bank of North America v. Bangs, 106 Mass. 441 (1871) (pointing out same thing). This paper is not concerned with the intricacies of what constitutes a loss or change of position—a question not peculiar to the clearing house.

\textsuperscript{82} See the parenthetical comments in the footnote next preceding.


\textsuperscript{85} Hallenbeck v. Leimert, 295 U.S. 116 (1935); Preston v. Canadian Bank of Commerce, 23 Fed. 179 (N.D. Ill. 1883). Nothing appears in either case indicating whether or not the defendant had changed his position. Evidently the court considered it immaterial.
met, it has been stated that in Massachusetts and New York the drawee bank may recover even though the check is not returned within the clearing house time limit, provided the defendant has suffered no loss by reason of the delay. But a study of the cases reveals that the statement is not entirely accurate. In fact, in Boylston National Bank v. Richardson, wherein the teller did not investigate the drawer's account until after the time stipulated by the clearing house rule for the return of not good items, the court denied recovery despite the fact that apparently the defendant had not changed its position. If change of position is the sole test in Massachusetts, the plaintiff should have won. The court emphasized the point that the transaction did not give rise to any mistake of fact in the legal sense, but merely showed laches on the teller's part in failing to examine the account. Examination of the Boylston case and the other Massachusetts authorities discloses that the plaintiff is not entitled to recover unless the delay in returning the item occurred because of some mistake of fact.

*Merchants' National Bank v. National Bank of the Commonwealth,* exemplifies the meaning of mistake of fact under the Massachusetts doctrine. The plaintiff bank held a quantity of sugar as security for a loan made to B. B informed the president of the bank that he had contracted to sell some of the sugar. Thereupon the president delivered to B the warehouse receipts for the sugar. It was agreed that the proceeds from the sale should be applied against B's debt. B sold the sugar and deposited the proceeds in his account with the plaintiff bank. A few days later B drew a check on the plaintiff bank, and it came through the clear-

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86. See *Brady, Bank Checks* 420 (2d ed. 1926). For a somewhat different statement of the Massachusetts rule see 24 *Banking L. J.* 91, 93 (1907).
87. 101 Mass. 287 (1869).
88. In the *Boylston* case the defendant was not the presenting bank, but was the prior holder of the check. However, this fact did not appear to be the determinative one.
89. Distinguished authorities have asserted that a negligent failure to discover the truth will not bar recovery in mistake of fact cases. *Woodward, Quasi Contracts* § 92 (1913); Ames, *The Doctrine of Price v. Neal*, 4 *Harv. L. Rev.* 297, 298 (1881). And in *Merchants Nat. Bank v. National Eagle Bank*, 101 Mass. 281 (1869), decided during the same year as the *Boylston* case, the court remarked that laches do not prevent recovery. In the *Boylston* case the drawee delayed several days before notifying the holder, but this did not seem to play an important part in the court's reasoning.
90. The absence of a mistake of fact resulted in a denial of recovery in *Atlas Nat. Bank v. National Exchange Bank*, 176 Mass. 300, 57 N.E. 605 (1900), in which, after the return hour, the drawee learned that the drawer had made an assignment for creditors. The case involved notes rather than checks, but there was evidence of a custom to return unpaid notes by a certain time. The lack of such a custom was responsible for a contrary result in *National Exchange Bank v. National Bank of North America*, 132 Mass. 147 (1882). Evidence of a custom varying the hour specified by clearing house rules has been held admissible. *Akron Scrap Iron Co. v. Guardian Sav. & Trust Co.*, 120 Ohio St. 120, 165 N.E. 715 (1929); *Banque Nationale v. Merchants Bank*, 7 *Montreal L. R.* 336 (1891) (alternative holding).
91. 139 Mass. 513, 2 N.E. 89 (1885).
ing house, reaching plaintiff about noon. Since B's account showed a sufficient balance, the check was debited against it, the bank not knowing that part of the balance arose from the sugar sale. About one o'clock, the termination of the period for making returns, the president of the bank, becoming suspicious, sent the check by messenger to the presenting bank and demanded repayment. The messenger arrived between 1:07 and 1:12. Defendant bank had not changed its position.

The court granted recovery, pointing out that a mistake of fact existed in that, unknown to the drawee bank, the amount of B's account available for withdrawal differed from the amount appearing upon the books. The absence of negligence on plaintiff's part was also noted by the court.92

The "mistake of fact" in Merchants' National Bank v. National Eagle Bank93 was of a more peculiar nature. At 12:45, fifteen minutes before the deadline and in time to reach the defendant bank by one o'clock, the drawee bank's messenger set forth to return a number of not good items, including the check in question. He became confused about the destination of another of the items, and came back to the drawee bank to be straightened out. As a result, he did not reach the defendant bank until between 1:05 and 1:07. The court allowed the drawee to recover on the basis of mistake of fact, declaring that the circumstances paralleled a payment over-the-counter by mistake. The parallel is difficult to follow, for in the principal case there was no intent at any time to pay the item, and it requires quite a stretch of the imagination to assimilate this to an intentional payment made in ignorance of the true state of affairs.94

Perhaps because the court sensed the fallibility of its pronouncement upon the mistake of fact phase of the transaction, a good part of the opinion was devoted to an interpretation of the clearing house rule, calculated to bring about the result considered equitable by the court. Yet looking at the opinion as a whole, it does not appear that the court intended to hold that the rule had been complied with and that, therefore, the check had never been paid. Rather, it appears in the last analysis,

92. The court distinguished Boylston National Bank v. Richardson, 101 Mass. 287 (1869), supra note 87, upon the ground that the transaction in that case showed laches rather than mistake of fact.
93. 101 Mass. 281 (1869).
94. In Preston v. Canadian Bank of Commerce, 23 Fed. 179 (N.D. Ill. 1883), supra note 85, the court declared that Merchants' Nat. Bank v. National Eagle Bank went to the verge in its application of the mistake of fact rule. In the Eagle Bank case the court also laid some emphasis upon the wording of the clearing house rule. The rule did not stipulate that items should be returned by one o'clock; instead, it provided that checks should not be retained after one o'clock. However, this argument appears to have been abandoned in the subsequent Massachusetts decisions.
that the court meant to treat the case as one involving payment under mistake of fact.\textsuperscript{95}

Still nearer the border in its application of the mistake of fact principle is the New York case of \textit{Citizens' Central National Bank v. New Amsterdam National Bank}.\textsuperscript{96} There, the messenger did not become confused, but simply failed to leave the drawee bank soon enough, and, as a consequence, arrived at the presenting bank between four and ten minutes late. In allowing recovery, the court lauded the Massachusetts authorities, quoting extensively therefrom and stating that the mistake in the New York case was the same in kind as that existing in \textit{Merchants' National Bank v. National Eagle Bank}.

To bolster its opinion the New York court also resorted to the wording of the clearing house rule. The rule provided that return of not good checks "should be made" before three o'clock. The court opined that those words made the rule advisory rather than mandatory. It is difficult to tell which ground predominated in the mind of the court.

The New York case and the two Massachusetts cases allowing recovery enjoy one very important factor in common—a factor of no influence theoretically, but of major significance from a practical standpoint. In each of them the returned item reached the defendant bank within a very few moments after the deadline. Whether a materially greater delay, caused, for example, by the messenger's consumption of a sleeping potion under the mistaken belief that it was a "shot" of coca cola, would alter the result of the lawsuit in those states, only their courts can say.\textsuperscript{97}

\textbf{Deferred Posting Legislation}

In view of the clearing house regulations permitting the drawee bank to return items within certain time limits, and the judicial approval of such regulations, it may be wondered why legislative action was necessary. Actually, the need arose from the institution by banks of a procedure called deferred posting, under which the bookkeepers post the

\textsuperscript{95} This conclusion is fortified by the remarks of the court in Merchants' Nat. Bank v. National Bank of the Commonwealth, 139 Mass. 513, 2 N.E. 89 (1885), \textit{supra} note 91. That this latter case was based upon the payment by mistake theory is proved by the measure of damages. Had the court intended to hold that the check was returned on time, the plaintiff bank would have been entitled to reimbursement for the full amount. Instead, the court limited recovery to the amount in excess of the sum against which the depositor was entitled to draw.

\textsuperscript{96} 128 App. Div. 554, 112 N.Y. Supp. 973 (1st Dep't 1908), aff'd without opinion, 198 N.Y. 520, 92 N.E. 1080 (1910). A vigorous dissenting opinion was written by Judge Ingraham.

\textsuperscript{97} For a criticism of the position taken in the Massachusetts and New York decisions, see Ames, \textit{The Doctrine of Price v. Neal}, 4 \textit{Harv. L. Rev.} 297, 305 (1891).
various items on the day after their receipt by the bank. This deferred posting was an outgrowth of the shortage of personnel and machines during World War II. Originally conceived as a wartime measure, it endured after the war because of increasing business, continuing employee shortage, and the need for more efficient operation.

The posting of items and their return through the clearing house on the day of receipt requires completion within a few hours of the entire process of sorting, proving, paying, and dishonoring. The extreme pressure incident thereto is materially relieved by the delayed posting process. The process saves time and reduces error, inasmuch as the bookkeepers may do all their posting at one time without interruption. It results in neater ledger sheets because of less handling. It improves employee morale by lessening the pressure and spreading the work more evenly. As suggested above, it enables the bank to do the same amount of work with fewer people. With all these and other advantages resulting in increased efficiency and decreased cost of operation, it is small wonder that deferred posting is now generally in effect. Despite the fact that deferred posting means later return of dishonored checks, there appears to be no substantial complaint on the part of bank customers.

It is obvious that under deferred posting, pertinent information, such as the state of the drawer's account, will not be available until the day after the check has been received by the bank, and dishonored checks cannot conveniently be returned until all the previous day's items have been posted. As a consequence, it is likely that more than twenty-four hours will elapse between the receipt of the check and its return. To the uninitiated, this presents no insurmountable problem. The solution apparently lies simply in changing the deadline contained in the clearing house rule. Indeed, a majority of clearing houses did exactly that without any deleterious results. But many clearing house officials and attorneys feared that under the Negotiable Instruments Law a delay of more than twenty-four hours would automatically impose liability on the drawee bank and amount to payment, thereby precluding the right to

98. The factual material on deferred posting and delayed returns was derived from the following articles: Fitch, Doskey, and Ruhlman, Paying and Posting Delayed in at Least Two Cities, 58 BANKERS MONTHLY 347 (1942); Lawson, Clearing The Way For Deferred Posting, Burroughs Clearing House, June 1948, p. 24; Lawson, Deferred Posting and Delayed Returns. Banking, Jan. 1949, p. 56; 28 Banks Benefit From Deferred Posting, 59 BANKERS MONTHLY 197 (1942); 90 Clearing Houses Now Return Checks the Next Day, 60 BANKERS MONTHLY 197 (1943); New State Law Allows Delayed Return of Items, 60 BANKERS MONTHLY 256 (1943); 187 Clearing Houses Delay Returns: Six States Have New Laws, 61 BANKERS MONTHLY 57 (1944); Members of 279 Clearing Houses Now Benefit From Deferred Posting, Bankers Monthly, Sept. 1948, p. 24; 47 States Now Permit Deferred Posting, Banking, Aug. 1951, p. 43.

return the check. And in view of the case law in some states, their fears were not groundless.\textsuperscript{100}

To retain the practical benefits of deferred posting and delayed returns, while removing the legal dangers, the American Bankers Association drafted a model deferred posting statute which was completed in November, 1948. Previously, a few states had adopted similar statutes. Forty-seven states and the District of Columbia have now enacted either the model statute or its counterpart, and most clearing houses have extended their deadlines accordingly.

The model statute gives the drawee bank until midnight of its next business day after the receipt of an item within which to dishonor or *refuse payment of the item. As a corollary, it authorizes the bank to revoke credits and other book entries, return the item, and obtain a refund of, or credit for, the amount of the item.\textsuperscript{101} Items received for immediate payment over the counter are excepted, and provision is made for the variation of the "effect" of the Act by agreement.

Consideration of the deferred posting legislation leads to the conclusion that it adopts the California rule in allowing revocation of over-the-counter credits; that it dispenses with the necessity of proving a custom, or a contract by deposit slip or passbook; that it does not disturb existing law concerning recovery of money paid under mutual mistake of fact, as in the case of a forged indorsement; and that its only effect on clearing house transactions is to legalize a deadline of more than twenty-four hours for the return of dishonored items, thus bringing the law into conformity with modern banking and clearing house practice.\textsuperscript{102}

\textsuperscript{100} For an explanation of the legal risks, see Leary, \textit{Deferred Posting and Delayed Returns—The Current Check Collection Problem}, 62 \textit{Harv. L. Rev.} 905, 917 \textit{et seq.} (1949); Note, 50 \textit{Col. L. Rev.} 802, 819 \textit{et seq.} (1950); Note, 63 A.L.R. 1138 (1929).

\textsuperscript{101} For a case allowing revocation in an over-the-counter credit transaction under a deferred posting statute similar to the model statute, see Hansen v. Bank of America Nat. Trust & Sav. Ass'n, 101 Cal. App.2d 300, 225 P.2d 665 (1950). The model deferred posting statute is discussed in the article by Leary, \textit{supra} note 100, at 626.

\textsuperscript{102} Deferred posting under the proposed Uniform Commercial Code is not treated in this article. For excellent discussions of the subject, see Leary, \textit{Deferred Posting and Delayed Returns—The Current Check Collection Problem}, 62 \textit{Harv. L. Rev.} 905 (1949); Notes, 50 \textit{Col. L. Rev.} 802 (1950); 59 \textit{Yale L.J.} 961 (1950); Banking, July 1951, p. 79. Since the publication of those materials the final text edition of the Uniform Commercial Code, dated November 1951, has appeared. It contains changes from previous drafts. The Code now has the approval of the American Law Institute, the Commissioners on Uniform State Laws, and the House of Delegates of the American Bar Association. The comments on the final text edition have not yet been published. Deferred posting appears to be authorized, \textit{e. g.}, § 4-301. \textit{But cf.} § 4-303, relating to stop payment orders and other matters. Will adoption of the Uniform Commercial Code entail repeal of present deferred posting statutes?